



**REVIEW OF PHARMACEUTICAL TAX CREDIT
FOR SENIOR CITIZENS**

**From The Office Of State Auditor
Claire McCaskill**

**Report No. 2001-34
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www.auditor.state.mo.us**

AUDIT REPORT



Office Of The
State Auditor Of Missouri
Claire McCaskill

April 2001

www.auditor.state.mo.us

The following areas of concern were discovered as a result of a review conducted by our office of the Pharmaceutical Tax Credit for Senior Citizens.

The Department of Revenue may have allowed ineligible taxpayers to receive the Pharmaceutical Tax Credit. The department adjusted 1999 Missouri individual income tax returns for approximately 105,000 individuals who met income and age requirements provided by law, but failed to claim the Pharmaceutical Tax Credit. According to the department, the tax credits allowed in connection with these 105,000 adjustments totaled approximately \$18.6 million.

When applying this tax credit to returns, the Department of Revenue did not determine whether the individual had received full reimbursement of the cost of pharmaceuticals from Medicaid or Medicare or whether the taxpayer actually incurred any pharmaceutical expenses.

In another tax relief measure available to senior citizens, the Senior Property Tax Relief Bill, the law includes a provision requiring the Department of Revenue to notify taxpayers of potential eligibility if it appears that the taxpayer could be eligible, but did not claim the credit. However, the department does not adjust taxpayers' returns unless the taxpayer subsequently files a claim for the credit. If such a statutory provision or practice had been in place for the Pharmaceutical Tax Credit, the costs to the state for this tax credit could have been reduced.

The Department of Revenue's tax policy group has determined that the Pharmaceutical Tax Credit will not be applied for tax year 2000 when taxpayers do not apply the credit to their individual income tax returns.

The fiscal note prepared by the Office of Administration and the Committee on Legislative Research significantly underestimated the financial impact of the Pharmaceutical Tax Credit on the state's General Revenue Fund. The Committee's final estimate of the fiscal impact of the Pharmaceutical Tax Credit on the state's General Revenue Fund was approximately \$20 million; however, according to the Department of Revenue, the actual fiscal impact of this credit was approximately \$83 million.

The section of the fiscal note completed by the Office of Administration estimated that approximately 261,000 Missouri residents could utilize the Pharmaceutical Tax Credit. According to Office of Administration personnel, this estimate was based upon household income information obtained from the United States Census Bureau, rather than an individual's adjusted gross income, as provided by state law. Using this information, the

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Office of Administration estimated the fiscal impact of the tax credit would be \$39.7 million. According to the Department of Revenue, there were approximately 458,000 individuals that utilized the Pharmaceutical Tax Credit for tax year 1999.

The Committee on Legislative Research used the same flawed data as the Office of Administration; however, the Committee further assumed that only fifty percent (approximately 130,000) of the Office of Administration's estimated eligible taxpayers would actually utilize the credit. Committee personnel indicated the fifty percent utilization rate was based on the utilization rate of other tax credits having similar eligibility requirements; however, there was no documentation to support this assumption.

The Department of Revenue was not specifically asked by the Office of Administration or the Committee on Legislative Research to provide statistical data regarding utilization of the tax credits or age and income data for taxpayers. Had the Office of Administration or the Committee sought and used available statistical data, the estimate of the fiscal impact of the Pharmaceutical Tax Credit would have been more accurate.

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FOR SENIOR CITIZENS

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STATE AUDITOR'S REPORT



CLAIRE C. McCASKILL
Missouri State Auditor

Honorable Bob Holden, Governor
and
Mike Hartmann, Commissioner
Office of Administration
and
Carol Russell Fischer, Director
Department of Revenue
and
Jeanne Jarrett, Director
Committee on Legislative Research, Oversight Division
Jefferson City, MO 65101

We have reviewed the establishment and administration of the Pharmaceutical Tax Credit for Senior Citizens, authorized by Senate Bill 14, 90th General Assembly, First Regular Session, effective August 28, 1999, and Section 135.095, RSMo 2000. The scope of this review included examining the Pharmaceutical Tax Credit for tax year 1999. The objectives of this review were to determine if:

1. The Pharmaceutical Tax Credit was appropriately applied by the Department of Revenue (DOR).
2. The Pharmaceutical Tax Credit was appropriately linked to actual expenses incurred by taxpayers.
3. The fiscal impact of the Pharmaceutical Tax Credit was reasonably estimated in the fiscal note provided by the Committee on Legislative Research, Oversight Division (Committee).

Our review was conducted in accordance with applicable generally accepted government auditing standards and included such procedures as we considered necessary in the circumstances. In this regard, we interviewed DOR, Office of Administration, and Committee personnel and reviewed state income tax forms, state laws, and fiscal note documents. We did not review income tax returns and related source documents. Access to these returns and documents was denied by the Director of Revenue based on the DOR's interpretation of the decision rendered by the Missouri Supreme Court in the case of Director of Revenue v. State Auditor 511 S.W.2d 779 (May 1974). As a result, we were unable to verify some of the information provided by the DOR.

Our review was limited to the specific matters described above and was based on selective tests and procedures considered appropriate in the circumstances. Had we performed additional procedures or been permitted access to income tax returns and related source documents, other information might have come to our attention that would have been included in this report.

The accompanying Management Advisory Report presents our findings arising from our review of the Pharmaceutical Tax Credit for Senior Citizens.

A handwritten signature in black ink, reading "Claire McCaskill". The signature is fluid and cursive, with the first name "Claire" written in a larger, more prominent script than the last name "McCaskill".

Claire McCaskill
State Auditor

February 22, 2001 (fieldwork completion date)

The following auditors participated in the preparation of this report:

Director of Audits:	Kenneth W. Kuster, CPA
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MANAGEMENT ADVISORY REPORT SECTION

REVIEW OF PHARMACEUTICAL TAX CREDIT
FOR SENIOR CITIZENS
MANAGEMENT ADVISORY REPORT-
STATE AUDITOR'S FINDINGS

1.	Department of Revenue Administration of the Tax Credit
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- A. The Department of Revenue (DOR) may have allowed ineligible taxpayers to receive the Pharmaceutical Tax Credit. The DOR adjusted 1999 Missouri individual income tax returns to apply the Pharmaceutical Tax Credit when eligible taxpayers (age 65 or older with an adjusted gross income of \$24,900 or less) did not claim the credit. According to the DOR, the amount of the Pharmaceutical Tax Credit was adjusted for approximately 117,000 taxpayers for tax year 1999 (this includes both returns adjusted to apply or increase the credit and returns adjusted to reduce the amount of credit claimed). Approximately 105,000 of these adjustments were for individuals who met the income and age requirements, but failed to claim the credit. According to the DOR, the tax credits allowed in connection with these 105,000 adjustments totaled approximately \$18.6 million.

When applying this tax credit to returns, the DOR did not determine whether the individual had received full reimbursement for the cost of pharmaceuticals from Medicaid or Medicare or whether the taxpayer actually incurred any pharmaceutical expenses. Pursuant to Section 135.095, RSMo 2000, “. . . no individual who receives full reimbursement for the cost of legend drugs from Medicare or Medicaid . . . shall qualify for the credit pursuant to this section”.

In another tax relief measure available to senior citizens, the Senior Property Tax Relief Bill, the law includes a provision requiring the DOR to notify taxpayers of potential eligibility if it appears that the taxpayer could be eligible, but did not claim the credit. However, the DOR does not adjust taxpayers' returns unless the taxpayer subsequently files a claim for the credit. If such a statutory provision or practice had been in place for the Pharmaceutical Tax Credit, the costs to the state for this tax credit could have been reduced.

The DOR's tax policy group has determined that the Pharmaceutical Tax Credit will not be applied for tax year 2000 when taxpayers do not apply the credit to their individual income tax returns. As a result of this change, we have no further recommendations.

- B. Section 135.095, RSMo 2000, which authorizes the Pharmaceutical Tax Credit, states that the credit is “...for the purpose of offsetting the cost of legend drugs...”. However, the law does not expressly require that actual pharmaceutical expenses be incurred by a taxpayer to receive the credit. In addition, the 1999 Missouri individual income tax form instructions for the Pharmaceutical Tax

Credit made no reference to whether the taxpayer must have incurred pharmaceutical expenses. The instructions specifically stated “If you were 65 or older as of December 31, 1999 and you are a resident of Missouri, you may receive a pharmaceutical tax credit of up to \$200”. The instructions also explained that the taxpayer’s income must be less than \$24,900 to receive the full credit. The only stipulation for receiving the credit noted in the instructions was whether the taxpayer met the income requirement or received full reimbursement by Medicaid or Medicare for the cost of pharmaceuticals. Because of the omission of any reference to actual expenses incurred, a taxpayer who did not bear any pharmaceutical expenses during tax year 1999 could have applied for and received this tax credit. The 2000 Missouri individual income tax form instructions have been changed to include the statement “If you did not have any pharmaceutical expenses, enter zero (0) on line 39”.

Although the law authorizing the tax credit has not been changed, the DOR has instituted changes to the 2000 individual income tax form instructions to address this concern. Nonetheless, clarifications to the law should be considered. As a result of the changes made by the DOR, we have no further recommendations.

2.	Fiscal Note Preparation
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The fiscal note prepared by the Office of Administration (OA) and the Committee significantly underestimated the financial impact of the Pharmaceutical Tax Credits to the state’s General Revenue Fund. The primary reason for the erroneous estimates appeared to relate to the assumptions or methods used to determine the number of eligible taxpayers.

- A. The section of the fiscal note completed by the OA and provided to the Committee for review estimated that approximately 261,000 Missouri residents age 65 and over could utilize the Pharmaceutical Tax Credit. According to OA personnel, this estimate was based upon household income information obtained from the United States Census Bureau, rather than an individual’s adjusted gross income, as provided by Section 135.095, RSMo 2000. Using this information, the OA estimated the fiscal impact of the tax credit would be \$39.7 million. According to the DOR, there were approximately 458,000 individuals that utilized the Pharmaceutical Tax Credit for tax year 1999. Since the number of taxpayers who were eligible for the tax credit was significantly underestimated, the loss of revenue to the state’s General Revenue Fund was not accurately determined by the OA.
- B. The Committee used the same flawed data as the OA; however, the Committee further assumed that only fifty percent (approximately 130,000) of the OA’s estimated eligible taxpayers would actually utilize the credit. Committee personnel indicated the fifty percent utilization rate was based on the utilization rate of other tax credits having similar eligibility requirements; however, there

was no documentation to support this assumption. The Committee's final estimate of the fiscal impact of the Pharmaceutical Tax Credit on the state's General Revenue Fund was approximately \$20 million.

According to the DOR, approximately 458,000 Pharmaceutical Tax Credits, totaling approximately \$83 million, were actually utilized for tax year 1999. The DOR applied the tax credit to approximately 105,000 taxpayers; therefore, approximately 353,000 taxpayers applied the credit before submitting their income tax returns to the DOR. The actual number of taxpayers utilizing this tax credit was more than triple the number estimated by the Committee, and the actual loss of revenue to the state's General Revenue Fund was more than four times the amount estimated by the Committee.

The DOR was not asked by the OA or the Committee to provide statistical data from prior years regarding utilization of tax credits or the number of taxpayers age 65 or older with an adjusted gross income of less than \$25,000. Had the OA or the Committee sought and used available statistical data, the estimate of the fiscal impact of the Pharmaceutical Tax Credit would have been more accurate.

WE RECOMMEND the Office of Administration and the Committee on Legislative Research, Oversight Division ensure relevant and accurate data is used in the preparation of fiscal notes. Furthermore, we recommend documentation be obtained and retained by the Committee to support any assumptions used to determine the fiscal impact of proposed legislation.

AUDITEE'S RESPONSE

The Director of the Office of Administration, Division of Budget and Planning provided the following response:

The Office of Administration agrees with the State Auditor's finding, and has previously acknowledged, that the impact of the tax credit authorized by Senate Bill 14 was underestimated. The Office of Administration agrees with the State Auditor that relevant and accurate data should be used in all fiscal notes and has already put in place appropriate safeguards.

The Director of the Committee on Legislative Research, Oversight Division provided the following response:

The Department of Revenue made policy decisions that likely contributed to an over-utilization of the pharmaceutical tax credit. In effect, the credit was refunded to more individuals than intended. However, the only way to determine the extent of the overpayments is to conduct a statistical sample of the tax returns and arrive at an error rate that could then be projected over the population.

The Office of Administration, in responding to Oversight's request for fiscal information in 1999, computed an estimated revenue impact for the proposed Pharmaceutical Tax Credit of \$39.7

million annually. This amount was reportedly based on the number of individuals with income of between \$10,000 and \$25,000. The numbers were simply labeled “income” and Oversight assumed they were compiled based on the provisions in the bill. The Department of Revenue was asked to provide data regarding revenue impact, but reported an “unknown” revenue impact to Oversight. It is presumed the executive branch departments will provide all information available, including statistical data from prior years, to compute fiscal impact. The information was sought through our standard request for fiscal information, which is submitted to all agencies affected by a bill.

In the preparation of the fiscal note, Oversight used the numbers computed by the Office of Administration and also assumed a 50% utilization rate for the Pharmaceutical Tax Credit. In our best judgment and relying on the experience with another credit targeting low-income senior citizens, we felt this was appropriate. According to the University of Missouri Economic and Policy Analysis Center, the Senior Citizens Circuit Breaker program, as of the last available census data, only had a 37.0 percent utilization rate. Oversight believed a 50% utilization rate for this program was a conservative estimate. Had we been aware of what the Department of Revenue’s implementation strategy would be, we would have taken a different approach.

We completely agree with your assertion that relevant and accurate data should be used in the preparation of fiscal notes. We have met with the Department of Revenue to discuss the procedure for coordinating the preparation of future fiscal notes with the Office of Administration and our office. As the Department of Revenue is the department in possession of the historical data and the department that will be responsible for implementing tax proposals, we will ultimately rely on them to provide both revenue and administrative impact on such bills.

We regret that a comparison has been made between the fiscal note estimate and the results of a program implemented and administered differently than intended. We believe a determination of the accuracy of the fiscal note estimate should be based on a comparison of the estimate with amounts which would have been paid had the credit been implemented according to the legislative intent.

AUDITOR’S COMMENT

Although the standard fiscal estimate worksheet completed by state agencies for pending legislation does provide a template for agencies to indicate the fiscal impact on state funds, we have noted that it is a common practice for agencies to only note the operating impact of the proposed legislation. The DOR’s response to the fiscal note identified only the additional staff and operating costs to administer the tax credit. If it was “presumed” that the DOR would provide all applicable information and such information was not forthcoming, it is unclear why this information was not specifically requested by the Oversight Division. The Oversight Division did not follow up with the DOR about the availability of any additional information or request specific statistical data from the DOR when computing the fiscal impact of the Pharmaceutical Tax Credit legislation.

This report is intended for the information of the management of the state of Missouri and other applicable government officials. However, this report is a matter of public record and its distribution is not limited.

APPENDIX

Appendix
REVIEW OF PHARMACEUTICAL TAX CREDITS
FOR SENIOR CITIZENS

Missouri Revised Statutes

**Chapter 135
Tax Relief
Section 135.095**

August 28, 2000

Maximum amount, qualifications, phase-out of credit based on income, expiration date.

135.095. For all tax years beginning on or after January 1, 1999, but before January 1, 2005, a resident individual who has attained sixty-five years of age on or before the last day of the tax year shall be allowed, for the purpose of offsetting the cost of legend drugs, a maximum credit against the tax otherwise due pursuant to chapter 143, RSMo, not including sections 143.191 to 143.265, RSMo, of two hundred dollars. An individual shall be entitled to the maximum credit allowed by this section if the individual has a Missouri adjusted gross income of fifteen thousand dollars or less; provided that, no individual who receives full reimbursement for the cost of legend drugs from Medicare or Medicaid, or who is a resident of a local, state or federally funded facility shall qualify for the credit allowed pursuant to this section. If an individual's Missouri adjusted gross income is greater than fifteen thousand dollars, such individual shall be entitled to a credit equal to the greater of zero or the maximum credit allowed by this section reduced by two dollars for every hundred dollars such individual's income exceeds fifteen thousand dollars. The credit shall be claimed as prescribed by the director of the department of revenue. Such credit shall be considered an overpayment of tax and shall be refundable even if the amount of the credit exceeds an individual's tax liability.

(L. 1999 S.B. 14, et al. § 1)